The Colombian Government, on 26 June 2019, issued Decree 1146, which provides the new regulations for the thin capitalization rule. The new regulations implement the changes made to the thin capitalization rules as part of the tax reform enacted last year (Law 1943 of 2018).

Background

Under the modifications made to the thin capitalization rule, a taxpayer generally may not deduct for income tax purposes interest paid on loans that are acquired, directly or indirectly, from related parties (foreign or local) and exceed a 2:1 debt-to-equity ratio on average. To deduct the interest paid on loans, the taxpayer must have the creditor certify that the loan is not from a related party.

Additionally, the modifications maintained the original rule that excluded public services infrastructure projects carried out by companies, entities or special purpose vehicles. As such, the thin capitalization rule does not apply to the funding of transportation infrastructure projects.

Decree 1146

Decree 1146 defines several terms, including “warranty,” “back-to-back loan” and “operation in which a related company substantially acts as a creditor.”
These definitions are relevant for determining whether the thin capitalization rule applies to the debt. The Decree also includes a definition for “transportation service infrastructure” and maintains the definition for “public service infrastructure” set out in the previous regulations.

To determine whether a company is a related party, Decree 1146 requires taxpayers to apply the definitions of related party provided in the Colombian transfer pricing rules. Additionally, Decree 1146 includes the methodology for calculating whether there is an interest that is not deductible and/or capitalizable. This methodology generally follows the methodology provided in the prior regulations. However, the Decree modifies the methodology to only take into account debts with related parties and to take into account certain foreign exchange gains or losses in line with recent changes in the tax law, which require foreign exchange gain or loss to be recognized when it is realized (e.g., payment, liquidation or disposal).

If interest is not capitalizable because of the application of the limitation in the thin capitalization rule, the interest also is not deductible. In addition, the interest cannot be treated as a cost in any later tax year.

The Decree also sets forth the requirements and content of the certification that should be issued by the creditor to establish that the loan is not a related party debt. If the certification is issued abroad, it must be apostilled. If it is not in Spanish, it must be officially translated by the Ministry of Foreign Affairs or by an official translator. The creditor should attach to the certification the creditor’s good standing certificate or an equivalent document. Although it is not expressly stated, creditors may want to have their good standing certificates or equivalent documents apostilled and translated into Spanish.

The certification must be issued before the due date for filing the income tax return in which the taxpayer is requesting the interest deduction. The creditor must issue the certification only once. However, if the loan is modified, a new certification must be issued and the previous one retained.

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